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Why Europe needs a policy on inequality

Intereconomics


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Economic inequality within EU countries is characterised by large and persistent differences. In the mid-2000s the distances between nations were of a very significant magnitude, with a clear divide, for example, between Northern and Mediterranean countries. More precisely, in Germany, Spain, Greece, Ireland, UK, Italy, Poland and Portugal the Gini coefficient on disposable income was around or well above the threshold of 0.30. Denmark and Sweden, on the other hand, remained the least unequal advanced countries, with Gini values of around 0.23.¹

Despite these differences and in line with worldwide tendencies, almost all EU countries have experienced a worsening of economic inequality over the last 25 years. The preceding general tendency towards a narrowing of disposable income distribution started to be interrupted in the early 1980s giving way to a generalised increase in inequality. This increase, although characterised by differences in timing and magnitude and often a consequence of abrupt but unreversed changes, has been particularly strong in Finland, Norway, Germany, Portugal and Italy, as well as in the USA. A rise in income shares by the top quintile of the income distribution (the richest 20% of households) has been a key determinant of greater inequalities over the last decade in Finland, Norway, Sweden, Denmark, Germany, Austria and Italy, as well as in the USA and Canada. In the last twenty years, the average annual growth of the real income of the top quintile has been twice as large as that of the bottom quintile (the poorest 20% of households) in Finland, Sweden, the UK, Germany and Italy, as well as in the USA.²

The recession that followed the international financial crisis of 2008 is likely to further exacerbate income inequalities and increase the problems of unemployment and poverty in many European countries, making even higher the already high social costs of inequality.³

Inequalities in disposable income are the result of extremely complex processes involving all the markets, the redistributive activity of the welfare state and a series of social variables, including the composition of households, gender disparities, ageing of the population and immigration. It is not easy to evaluate the effect of each of these variables but they should be taken into account both in explaining overall inequality and in policymaking. As regards markets different from the labour market, a positive contribution to greater inequality has come in many countries from more concentrated capital and self-employment incomes. However, in order to understand recent developments, special attention has to be paid to the labour market and the redistributive activity of the welfare state, also because of their implications for crucial policy issues at the EU level.

In the last decade wage dispersion among workers increased in many countries. This tendency is mainly due to two key phenomena. The first is the pronounced increase, in several countries, in the earnings of the richest workers, to which top managers also belong. More generally, there has been a marked but not uniform increase across nations of the share of income going to a very small number of rich people (the top incomes) who can be classified as workers (even if of a special type) and not capitalists. This is a new phenomenon and under several aspects a very interesting one.

The second phenomenon concerns atypical workers, i.e. part-time, temporary and outsourced workers, earning low and intermittent wages, who significantly contributed to widening inequality especially in those countries where they are the greatest in number (Italy, Spain, Ireland and Germany). Such workers are also responsible, at least partially, for the quite disturbing presence of working people in the lower tails of the distribution, the “working poor”. More than disturbing is the consideration that such workers are often well endowed with human capital.


Both these and other tendencies have made for a pattern of changing distribution in labour income much different and more complex than the story told by the Skill Biased Technical Change hypothesis, which simply predicts a widening gap between skilled and unskilled workers.  

The overall effect has been a substantial stability of the average labour compensation in many countries while a growing share of European workers has experienced a decline in real wages. The proportion of the European workforce with a labour compensation per hour (wages plus social contributions) declining in real terms was 16.5% in the years 1996-1999 and 33% in 2003-2006. Moreover, 48% of the workforce during 1996-1999 and 61% during 2003-2006 saw their labour compensation per hour growing, on average, less than their labour productivity per hour. In the latter period, 23% of the workforce faced declining compensation with increasing labour productivity in their industry.  

Coupled with the low dynamics of labour productivity or the limited ability of labour to appropriate a significant share of productivity gains, such tendencies have resulted in a sharp increase of the profit share in the functional distribution of income. This change itself had an impact upon personal distribution of income. Since profits are usually less evenly distributed than wages, when their share in national income increases personal income inequality tends to increase as well.  

Higher wage dispersion in the labour market has very likely weakened the positive effect of growing employment which several countries experienced in the years preceding the 2008 crisis. Higher employment usually reduces disposable income inequality especially when it is coincident with an increase in the number of workers in relatively poor households. However, due to the counteracting effects of greater wage dispersion, the inequality reducing effect of employment has not been significant in many EU countries.  

The state, acting through taxation, social transfers and the provision of in-kind services can exert a strong influence upon disposable income distribution. To estimate how much such activities reduce the Gini coefficient is not an easy task. In particular, it is a really big problem to establish the redistributive effect of in-kind services. Anyhow, according to the most ac-
identify a clear-cut difference with respect to the USA, despite frequent claims to the contrary.

There are several reasons for arguing that inequality should be looked at from an EU-wide perspective rather than from national ones.

First of all, even if inequality within each country falls, the overall inequality at EU-level may very well increase. This happens if average national incomes tend to diverge so that a reduction in the dispersion of incomes around the national averages is not conducive to less overall inequality. In other words, higher between-countries inequality may cancel out the positive effects of a lower within-countries inequality. By adopting an EU-wide perspective it is possible to take both types of inequality into account. Indeed, in order to reduce inequality in Europe as a whole it is necessary to lessen the distance between the richest and poorest in the whole area, not only between rich and poor in each country.

Targeting inequality in Europe as a whole allows the treatment of two of the most important EU policies in a much more integrated way: social policies aimed at reducing within-countries inequality and regional policies concerned with disparities between countries. In more general terms, as inequality is affected by many factors, a much larger set of EU policies could be evaluated with regard to their effects on overall inequality in Europe. Today, the implemented policies are likely to have a negative impact, though unintentionally, on EU inequality.

A second reason in favour of a unified European perspective on inequality is its symbolic as well as practical implications for a deeper economic and social integration. It could strongly enhance the view of Europe as a single entity and of the EU as a body with a special concern for social cohesion in the area as a whole. Indeed, it is rather disappointing that EU-wide inequality does not play a leading role in the evaluation of EU policies on social cohesion. The national approach to these issues should be corrected so as to make it clear that Europe cares about social cohesion on a truly European supernational level. A less unequal Europe, different by far from less unequal European countries, is an important political objective as well as a condition for the achievement of other well-established policy objectives. A less heterogeneous Europe seems to be both a condition for, and a result of, deeper economic and social integration.

The above considerations show how the emphasis put on EU-wide inequality may have important implications, independently of extensive institutional changes. Inequality at a supernational level can be reduced even without a stronger supernational policy, provided that proper relevance to policymaking is given. However, and this is the third reason in favour of a European approach to inequality, a more coordinated policy could strongly enhance the effectiveness of a large set of measures against inequality.

A closer coordination among decision centres at both national and supernational levels may help to strike a better balance between institutional competition and harmonised policies. As far as inequality is concerned the need for harmonised policies looks quite strong – stronger than with respect to economic growth – and the EU could play a crucial role in favouring such policies. Our analysis above suggests that the effectiveness of welfare state redistribution may take advantage of a better harmonisation of fiscal policies limiting tax competition inside Europe. Also with respect to those evolutions in the labour market that have negatively affected wage dispersion, a more coordinated policy could have positive effects. However, as stated repeatedly, inequality depends on a vast array of factors and policies and not only on labour and welfare policies. A well-designed set of country-specific and supernational policies may, above all, enable the achievement of lower inequality without sacrificing other important economic and social objectives.

How Much Inequality?

Making EU-wide inequality a policy objective can be justified on the ground that such inequality is high, that a coordinated approach is more effective and, finally, that it can positively interact with the process of constructing a more integrated and homogeneous Europe. However, in order to give priority to a policy against inequality other issues have to be faced. Why is inequality so important? How does it relate to other desirable objectives and in particular to economic growth? Such questions need convincing answers whatever the government level in charge of the policy.

It is not easy to say which level of income inequality is “fair” (and which is the best statistical measure to capture it). However, the present level of inequality in several EU countries seems to be in conflict with the values shared by a majority of European citizens. An

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10 OECD, op. cit.
are reasons to believe that the working of the labour advantages and disadvantages. In particular, there are amenable to the intergenerational transmission both by the degree of current inequality, making them more proof of many economic institutions, not only the phenomenon is not available. However, there are some others, S. Voitchovsky: Inequality and Economic Growth, in: W. Lower inequality is commonly considered an enemy of economic growth. This is indeed one of the most popular reasons for suspicion of egalitarian programmes. However popular this conviction may be, it does not rest on solid ground. Where inequality is greater, economic growth is not systematically faster. Indeed, we have no clear evidence that a wider economic inequality is favourable to economic growth or that reducing inequality is conducive to slower growth. Nor can we rely on a positive automatic effect of reduced inequality on economic growth. On the other hand, economic growth is not an infallible strategy for reducing inequality. Trickle-down effects are too weak to make a policy aiming for sustainable growth also a policy favourable to the reduction of inequalities. The conclusion to be drawn – which is at odds with the more common opinions on this issue, on both sides of the debate – is that inequality and growth should be considered relatively independent phenomena. A large number of institutions and policies, as well as the structural characteristics of the process of growth, through various complementarities and interconnections, play a crucial role in shaping the growth-inequality nexus. Policies aiming at reducing inequality without hampering growth are, therefore, possible: the problem consists in identifying and positively exploiting these complementarities and interconnections.

**Conclusion**

Inequality is about the distances that separate individuals and groups living in a society and conveys the idea that societies, at any level, should be concerned with such distances – not only with the worst off. In-

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equality has many dimensions, not only the economic one – predominantly captured by the distribution of income – which has been the focus of the present paper. However, even if we concentrate on the economic dimension, we can identify a series of arguments calling for an explicit and unified European policy against inequality.

Such arguments refer not only to the high level of inequality within several European countries, but also, and primarily, to the high level of inequality in Europe as a whole. Looking at Europe as if it were a single country has several advantages when dealing with inequalities: the effectiveness of existing policies can be enhanced through joint consideration of within-countries and between-countries inequality; further policies based on a better degree of coordination can be devised, and economic and social integration can positively interact with policies targeted to reduce EU-wide inequality.

On the other hand, there are several good reasons for making the reduction of inequality a priority of European policies. High inequality is positively related to a series of social “bads” and may also make the inter-generational transmission of advantages and disadvantages easier. The alleged negative effect of lesser inequality on economic growth is not well corroborated by existing evidence. For all these reasons inequality reduction (and more generally, inequality control) should rate high on the political agenda of Europe as a whole.